



Clerk of the Board  
California Air Resources Board  
1001 I Street  
Sacramento, California 95814

23 June 2012

## **IETA COMMENTS ON DRAFT AMENDMENTS TO THE REGULATIONS FOR LINKING WITH QUEBEC CAP-AND-TRADE PROGRAM (PROPOSED REGULATION ORDER APPENDIX A.1 & A.2)**

On behalf of the International Emissions Trading Association (IETA), we are grateful for the opportunity to provide comments in response to California Air Resources Board (ARB)'s release of the Proposed Regulation Order "Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions". We hope that IETA's perspectives and recommendations are carefully considered before the latest round of draft rules are finalized in June 2012. A clear summary of IETA's key observations and recommendations can be found in **Annex 1** to this document.

IETA extends its appreciation to California for the release of draft regulatory amendments, taking into consideration the linking of its cap-and-trade program with other Western Climate Initiative (WCI) partner jurisdictions. The aim of WCI is to take cooperative actions to address climate change, and linking programs is a critical component of achieving this goal. Linking leads to price discovery, which helps to reduce program costs by broadening the scope of available mitigation opportunities while further sparking competition to innovate and mitigate greenhouse gas emissions. Moreover, linkage increases market liquidity and reduces transaction costs by involving more market participants, which also lowers the potential for market manipulation. A carefully designed and well-executed linkage of these programs, which builds off valuable experiences and lessons learned from other environmental markets, will help maximize these benefits as well as maintain California's international reputation as a climate policy leader.

### **INTRODUCTION**

IETA is dedicated to the establishment of market-based trading systems for greenhouse gas emissions that are demonstrably fair, open, efficient, accountable, and consistent across national boundaries. IETA has been the leading voice of the business community on the subject of emissions trading since 2000. Our 150 member companies include some of North America's, and the world's, largest industrial and financial corporations—including global leaders in oil & gas, mining, power, cement, aluminum, chemical, pulp & paper, and investment banking. IETA also represents a broad range of global leaders from the industries of: data verification and certification; brokering and trading; offset project development; legal and advisory services.

For over a decade, IETA has remained committed to its vision of a global greenhouse gas market. To this end, IETA has facilitated thought leadership on linking through its original research. In preparation for COP 13 in Bali in 2007, IETA commissioned Dr. Robert Stavins (Harvard University) and Judson Jaffe (formerly of the Analysis Group) to write the first comprehensive report on linking. Since this report, IETA has continued to view linking as a critical component of creating a consistent, fair and cost-effective international framework for reducing greenhouse gases.



## OVERVIEW OF SUBMISSION

Recognizing that ARB's May 9<sup>th</sup> linking Appendix A.2 to the "Notice of Proposed Linking" document is largely similar to the March 30<sup>th</sup> discussion draft, for which IETA previously submitted comments on April 13<sup>th</sup>, the current submission re-emphasises recommendations that IETA believes have not yet been adequately addressed by ARB. In addition, this submission raises several new issues and observations, which we believe are important for ARB to consider while moving forward.

This particular submission is structured around the following categories:

- 1. Know-Your-Customer Requirements;**
- 2. Compliance Instrument Transfer Price Reporting;**
- 3. Language Replacing Beneficial Holdings; and**
- 4. Further Recommendations and General Comments.**

IETA's intent is to assist ARB, in any way helpful, to strike the right balance between market oversight and market effectiveness in California's new market. For a summary of IETA's key observations and recommendations, see **Annex 1**.

### 1. KNOW-YOUR-CUSTOMER REQUIREMENTS

IETA's April 2012 submission to ARB addressed the Know-Your-Customer (KYC) requirements for which ARB had specifically asked for stakeholder input<sup>1</sup>. Aside from the addition of a criminal record provision, ARB has left KYC requirements largely as written in the March 2012 Discussion Draft, to the concern of IETA members.

As previously expressed to ARB, we believe the proposed KYC requirements too heavily emphasize market oversight at the expense of market participation. We believe that only slight adjustments to the current draft KYC requirements will help to ensure widespread and successful participation in ARB's program without sacrificing market security. IETA's recommended changes to the proposed KYC requirements are summarized below.

**Consider a policy that removes requirements for publicly traded companies that comply with U.S. Securities and Exchange Commission (SEC).** SEC regulated companies are closely regulated by multiple Federal Agencies. Furthermore, they are required to disclose a host of detailed information that is readily researchable. IETA believes ARB could work in conjunction with the SEC to: 1) ensure appropriate market oversight; and 2) maximize participation by avoiding requiring publicly traded companies that comply with SEC to disclose similar information twice. Therefore, IETA recommends that ARB considers exempting publicly traded companies that are in compliance with the SEC from ARB's KYC requirements.

**Consider removing onerous requirements for personal information.** IETA believes requiring that individuals disclose excessively onerous information, such as personal bank account information, to gain access to the tracking system is unnecessary. When a company registers in the California program, ARB will be provided detailed information about this company, such as tax ID

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<sup>1</sup> § 95834, p. 73 of March 30<sup>th</sup> Discussion Draft Amendments.



numbers, affiliates, officers, etc. A registered entity is accountable for the actions of its representatives entrusted with its account authorization. It should be left to the prerogative of individual companies to conduct background checks on their own employees. Accordingly, IETA recommends ARB consider eliminating provisions requiring overly onerous information disclosure for individuals. At the very last, IETA urges ARB to consider differentiating requirements for individuals who are applying for access to accounts for two distinct purposes: 1) strictly viewing purposes; and 2) purposes that include additional responsibility (i.e. a primary account representative). For individuals falling in the former category, IETA recommends eliminating the provisions that require disclosure of overly onerous personal information.

**Electronic document submission should be allowed.** The KYC requirements in place in the European Union Emissions Trading Scheme (EUETS), like the requirements proposed in ARB's draft amendments, require notarized documentation. However, in contrast to the EU ETS, ARB does not grant itself the additional authority to use electronic mechanisms to check disclosed information. This requirement is unnecessary and could prove to be excessively costly. Requiring identity verification to be conducted in-person also limits the ability of a company to nominate other representatives, if necessary (and without the need to travel). Therefore, IETA recommends that ARB authorize the use of electronic mechanisms to check any personal information.

**Consider Potential Participation Implications Prompted by US Bank Account Requirements.** Finally, we believe that proposed requirements for individuals to hold a bank account in the U.S. for access to the tracking system is potentially problematic, particularly for multinational corporations who may register as Voluntary Auction Entities (VAEs) through a U.S. office branch, but whose trading desk may be located in another country. In such instances, traders within these registered companies may not have US bank accounts and would be unnecessarily prevented from accessing the tracking system. While moving forward with rule-making and implementation activities, we recommend ARB to consider possible participation implications associated with regional bank account constraints.

## 2. COMPLIANCE INSTRUMENT TRANSFER PRICE REPORTING

IETA believes that ARB's reporting requirements on compliance instrument transfers are unnecessary and problematic. Different types of transactions can create different problems. For example, it would be arbitrary to assign a specific transaction date and price to a net transfer of allowances that is the result of a number of bilateral transactions (i.e., transactions between two counterparties not cleared through an exchange) between the same counterparties that have netting arrangements contractually specified.

To further illustrate this point, consider the following scenario: *After having undertaken several buy and sell transactions of different amounts of allowances at different times for different prices, companies A & B look over their books and recognize that A sold B, in total, 100,000 allowances, and B sold A, in total, 75,000 allowances. Therefore, the "net" position, which A must deliver to B, is 25,000 allowances. Under the scenario, the two companies agree to "book out" the 75,000 allowances not needed to be delivered, and they agree to make one account transfer for the 25,000 net allowances owed. What is ARB's expectation for reporting on this type of situation? If only allowances delivered via account transfer are to be reported, how does ARB expect the reported price to be calculated?*



Further, a transaction of allowances with another commodity (e.g., power or gas) may not distinguish a price for the two commodities separately. Ultimately, under the current reporting rules, ARB may not be aware of all the terms of a transaction; and, even if a price can be reported, it will not necessarily be reflective of a “plain vanilla” California Carbon Allowance (CCA). One major concern is that public reporting of prices that cannot be separated from other commodities, or have other factors included in the price, may create confusion in the marketplace as well as lead to erroneous assumptions about the market.

If ARB believes it integral to monitor CCA transfer prices and trends, California regulators could accrue this information just as – if not more – effectively from exchanges, where prices reflect all transaction prices and volumes, thereby reducing administrative burden for individual transacting parties. In addition, this data would be much more contemporaneous than data provided at the time of transfer. In light of these concerns and observations, **IETA recommends that ARB does not require transaction price reporting.**

### 3. LANGUAGE REPLACING BENEFICIAL HOLDINGS

While IETA understands ARB’s rationale for eliminating beneficial holdings, we are concerned with the ambiguity of the language that remains to govern how accounts may be utilized. In particular, IETA is under the impression that ARB intends to allow situations whereby a broker may procure and accumulate compliance units to be later delivered to a client under contract. However, there is concern that the currently proposed language could be interpreted such that the above case could be deemed unacceptable. **IETA kindly requests ARB to provide additional clarity in its proposed amendments to ensure that the above situation is explicitly approved.**

In addition, **IETA requests ARB to provide explicit language in the rules, stating that an advisor may participate in the market on its own behalf and/or advise more than one company without violating the regulation,** to the extent such advisor acts in good faith and is not engaged in market manipulation.

### 4. FURTHER RECOMMENDATIONS AND GENERAL COMMENTS

#### Changes in the Transfer Process

IETA would like to re-state its view that ARB’s switch from the “two key” process to a “push-push-pull” method for transfer requests is unnecessary and unprecedented, and these regulations seem to bear no relation to traditional commercial markets. By regulation, a registered entity is bound by the actions of its representative; ARB therefore does not need to add further requirements.

While IETA understands ARB’s intent behind requiring three (3) representatives to sign-off on a transfer request, we believe that companies will effectively prevent theft and fraud through their own, internal control systems; therefore, IETA recommends removing this requirement in the final amended regulation. **Eliminating the requirement for multiple sign-offs would alleviate encumbrances and facilitate a more effective transfer process.**



**If provisions are retained, IETA urges ARB to consider changes to proposed language and deadlines, governing the transfer process.** The deadlines associated with requesting, approving, and confirming a transfer to ARB are extremely short and will unnecessarily burden companies. Therefore, IETA recommends ARB consider either eliminating or, at the very least, lengthening these proposed deadlines. In addition, IETA recommends that ARB modify the language to read two or one *business* days, respectively, instead of *calendar* days. This would prevent inconvenient situations where account representatives would have to sign-off on transfers over a weekend or holiday.

### Resource Shuffling

IETA is aware that specific opportunities to further comment on electricity issues, including resource shuffling, will soon arise, and we look forward to engaging with ARB during these future consultations. In the meantime, however, IETA would like to express ongoing concern about the lack of clarity, currently governing what will – or will not – be considered resource shuffling under California’s program. IETA is aware of ARB’s initial attempt to define resource shuffling as an intentional “plan, scheme, or artifice to receive credit based on emissions reductions that have not occurred”. However, more clarity from ARB will go a long way to ensure the certainty and confidence necessary for markets to function effectively. As the current guidelines stand, willing market participants cannot accomplish consistent compliance without clarity about what the rules allow, and what the rules prohibit. Absent further clarity on “resource shuffling”, some participants may elect to simply withdraw from the market entirely, or simply reduce their level of participation, out of fear of potential regulatory liability.

One possible solution for ARB’s consideration might exist through a “no-action” letter process, under which an entity may obtain formal, written, and confidential guidance as to whether a proposed transaction would constitute resource shuffling. Today, “no-action” letters are frequently issued by other regulatory agencies, including the Federal Energy Regulatory Commission (FERC), the Commodity Futures Trading Commission (CFTC), and the Securities and Exchange Commission (SEC). Going forward, IETA welcomes the opportunity to discuss various options with ARB staff, with a view to providing enhanced clarity on resource shuffling to help drive the development of a fully-functional, broad, and liquid California market.

### Number of Individuals Associated with an Account

IETA commends ARB for allowing the designation of more account representatives. This amendment will enhance the ability of entities to efficiently manage their accounts.

### Consolidation of Accounts between Entities with Direct Corporate Association

IETA commends ARB for proposing to switch from a facility-level to a corporate-level process for accounts by allowing for consolidation of accounts with direct corporate association.



## Holding Limits

In general, IETA advocates for the removal of holding limits. However, if California regulators insist on the inclusion of holding limits in California's program design, **IETA prefers ARB's original rules, which applied the limit for future vintage year allowances to all vintages within that compliance period.** We believe that ARB's latest approach to holding limits (i.e., for the holding limit for future vintage year allowances to apply to each vintage year allowance) will provide an unnecessary restriction on companies, particularly large covered companies who will be challenged to meet compliance obligations with holding limits in place.

## Auction Frequency

IETA was pleased to hear that, at least in concept, ARB is not entirely foreclosing the option of increasing allowance auction frequency in the future. Increasing auction frequency would preclude the need for additional measures that attempt to prevent market manipulation—like holding or auction purchase limits. In addition, more frequent auctions could result in a faster learning curve for companies and more opportunities to become comfortable with the auction platform. That said, we recognize that administrative burden and cost to participate in auctions, as currently designed, could greatly increase with increased auction frequency; all administrative burdens and cost requirements should be kept in mind, and effectively assessed & addressed, when and if ARB considers an increase in auction frequency.

## **CONCLUDING REMARKS**

The recommendations shared in IETA's comments are intended to improve market efficiency, liquidity, and overall functionality. We believe that ARB's release of draft regulatory amendments, ahead of linking with WCI partner jurisdictions, namely Quebec, is a positive step towards achieving greater liquidity. We believe that IETA's recommendations, if considered by ARB and implemented in the final rules, will ultimately help California's come closer to cost-effectively reaching its climate policy objectives.

IETA reiterates its gratitude, particularly to ARB staff, for their ongoing time & efforts in building California's carbon market, as well as for this opportunity to provide comments on the draft amendments. We welcome future engagement opportunities regarding California's linking process and beyond. If you have any questions, or further clarification is required, please do not hesitate to contact Robin Fraser ([fraser@ieta.org](mailto:fraser@ieta.org)) or Katie Sullivan ([sullivan@ieta.org](mailto:sullivan@ieta.org)).

Sincerely,

Dirk Forrister  
President and CEO



## ANNEX 1: SUMMARY OF IETA'S KEY OBSERVATIONS & RECOMMENDATIONS

ISSUE	KEY OBSERVATIONS & RECOMMENDATIONS
<b>Know-Your-Customer Requirements</b>	<ul style="list-style-type: none"> <li>▪ <b>Concern:</b> Draft rules too heavily emphasize market oversight at the expense of market participation.</li> <li>▪ <b>Main Argument:</b> Minor adjustments to KYC requirements will ensure widespread and program participation without sacrificing market security.</li> <li>▪ <b>Recommendation:</b> Exempt SEC-compliance publicly-traded companies from KYC requirements.</li> <li>▪ <b>Recommendation:</b> Remove provisions requiring onerous information disclosure for individuals.</li> <li>▪ <b>Recommendation:</b> If provisions requiring information disclosure for individuals cannot be removed entirely (see above recommendation), consider differentiating individual requirements, <u>based on purpose</u> of the applicant: 1) for strictly-viewing purposes; and 2) purposes that include additional responsibility (i.e., a primary account representative). For individuals falling under the former category, provisions requiring disclosure of overly onerous information should be eliminated.</li> <li>▪ <b>Recommendation:</b> Authorize the use of electronic mechanisms to check any personal information.</li> <li>▪ <b>Recommendation:</b> Requirements for individuals to hold bank accounts in the US for access to the tracking system is potentially problematic, particularly for certain international entities registering as VAEs.</li> </ul>
<b>Compliance Instrument Transfer Price Reporting</b>	<ul style="list-style-type: none"> <li>▪ <b>Concerns:</b> Draft reporting requirements on compliance instrument transfers are unnecessary and problematic. If only allowances delivered via account transfer are to be reported, there lacks clarity around how the reported price should be calculated. <b>A further concern is that</b> public reporting of prices that cannot be separated from other commodities (or other factors included in the price) may create confusion in the market, leading to erroneous market assumptions.</li> <li>▪ <b>Main Argument:</b> Different types of transactions can create different problems, and therefore reporting requirements must be clear, and they should be crafted in a manner that reflects distinct transaction types and associated challenges.</li> <li>▪ <b>Recommendation:</b> ARB should not require transaction price reporting. Regulators could effectively accrue price information from exchanges, where prices reflect all transaction prices and volumes.</li> </ul>
<b>Language Replacing Beneficial Holdings</b>	<ul style="list-style-type: none"> <li>▪ <b>Concern:</b> Draft language replacing beneficial holding provisions is ambiguous, causing questions and concerns about how accounts may be utilized.</li> <li>▪ <b>Recommendation:</b> Rules should clearly allow brokers to procure and accumulate compliance units to be later delivered to a client under contracts.</li> <li>▪ <b>Recommendation:</b> Rules should include explicit language stating that an advisor may participate in the market on its own behalf and/or advise more than one company without violating the regulation.</li> </ul>
<b>Changes in Transfer Process</b>	<ul style="list-style-type: none"> <li>▪ <b>Concern:</b> The proposed “push-push-pull” method for transfer requests is unnecessary and unprecedented, and it appears to bear no relation to traditional commercial markets.</li> <li>▪ <b>Recommendation:</b> Eliminate the requirement for three (3) representatives to sign-off on a transfer. Companies will prevent theft and fraud through internal, control systems and processes.</li> <li>▪ <b>Recommendation:</b> If above-mentioned provisions are retained, eliminate or at least lengthen the proposed deadlines for requesting, approving, and confirming a transfer to ARB.</li> <li>▪ <b>Recommendation:</b> Modify proposed language to read 2 or 1 <i>business</i> days instead of <i>calendar</i> days.</li> </ul>



<b>Resource Shuffling</b>	<ul style="list-style-type: none"><li>▪ <b>Concern:</b> Lack of clarity governing what will – or will not – be considered “resource shuffling” under California’s program.</li><li>▪ <b>Main Argument:</b> Absent further clarity and open consultation on “resource shuffling”, some participants may choose to withdraw from the market, or reduce level of level of participation, for fear of potential regulatory liability.</li><li>▪ <b>Request for Information:</b> IETA requests clarity on future planned/proposed rule-making activities and consultation opportunities related to “resource shuffling” and other electricity sector issues.</li></ul>
<b>Support for Specific Draft Amendments</b>	<ul style="list-style-type: none"><li>▪ <b>Number of Individuals Associated with an Account:</b> With a view to enhancing the ability of entities to more efficiently manage their accounts, IETA commends ARB for allowing the designation of more account representatives in the draft amendments.</li><li>▪ <b>Consolidation of Accounts between Entities with Direct Corporate Association:</b> IETA commends ARB for proposing to switch from a facility-level to a corporate-level process for accounts by allowing for consolidation of accounts with direct corporate association.</li></ul>
<b>Holding Limits</b>	<ul style="list-style-type: none"><li>▪ <b>Concern:</b> The change in the draft amendments—for the holding limit for future vintage year allowances to apply to each vintage year allowance—provides an unnecessary restriction on companies, particularly large companies facing compliance obligations.</li><li>▪ <b>Recommendation:</b> IETA advocates generally for the removal of holding limits. However, if they must exist business would prefer ARB’s original regulations for holding limits, which apply the limit for future vintage year allowances to all vintages within that compliance period.</li></ul>
<b>Auction Frequency</b>	<ul style="list-style-type: none"><li>▪ <b>Comment:</b> ARB should remain open to the option of increasing auction frequency in the future. Increasing auction frequency would preclude the need for additional measures that attempt to prevent market manipulation—like holding or auction purchase limits.</li></ul>